

## PAGE: 1 of 25

REVISION DATE: 6/30/2006

<b>PROGRAM/SUBJECT:     Cities and Towns - Long-Term Debt</b>	REF: C/T-8
	PAGE: 2 of 25

# **I. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:**

## **GENERAL OBLIGATION BONDS:**

### **1. Compliance Requirements:**

- Except for certain specified purposes, a city, or town cannot issue general obligation bonds without submitting the question of issuing such bonds to the registered electors at a general city or town election or at a special election that is held in conjunction with a regular or primary election. (Sections 7-7-4221, 4222, 4223, and 4226, MCA)
- The question of whether or not to issue general obligation bonds can be submitted to the electorate by resolution of the city or town council or commission. (Section 7-7-4223, MCA)
- The question of whether or not to issue general obligation bonds can be submitted to the electorate after there has been presented to the city or town council or commission a petition asking that such election be held and question submitted. The petition must be signed by not less than 20% of the qualified voters within the city or town. (Sections 7-7-4223, 4224 and 4225, MCA)
- Whenever the question of issuing bonds for any purpose is submitted to the registered electors of a city or town at a general election, at an election that is conducted by mail ballot, as provided in Title 13, chapter 19, MCA, or at a special election that is held in conjunction with a regular or primary election, the determination of the approval or rejection of the bond proposition is made by a majority of the votes cast on the issue. (Section 7-7-4235, MCA)
- A city or town may issue general obligation bonds by an adopted resolution of the governing body without an election for the following purposes:
  1. refunding bonds to refund bonds issued & outstanding, (Section 7-7-4221, MCA)
  2. issuing revenue bonds not pledging the general credit of the municipality under any laws of this state, (Section 7-7-4221, MCA)
  3. issuing amortization bonds for the purpose of refunding any outstanding bonds of the city or town held by the state and which were not issued either as amortization or serial bonds and to exchange the same for such outstanding bonds, and (Section 7-7-4275, MCA)
  4. bonds issued by a city for the purpose of deriving revenue for the repayment of tax protests lost by the city. (Section 15-1-402(7)(c))

<b>PROGRAM/SUBJECT:     Cities and Towns - Long-Term Debt</b>	REF: C/T-8
	PAGE: 3 of 25

**I.     COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:**

**GENERAL OBLIGATION BONDS - continued:**

**Suggested Audit Procedures:**

- If the entity issued general obligation bonds during the audit period, review documentation on file to determine that the question of issuing the bonds was submitted to the electorate by resolution initiated by the governing body, or by resolution initiated by a petition signed by not less than 20% of the qualified voters of the city or town.
- Review the election results and determine that the issuance of the general obligation bonds was properly approved by the voters, as described above.
- If general obligation bonds were issued by resolution of the city or town governing body during the audit period without an election, determine that they were issued for one of the allowable purposes described above.

**2.     Compliance Requirements:**

- If the voters approve the issuance of the general obligation bonds, a resolution must be passed by the governing body of the city or town that states the specific terms of the bonds. (Section 7-7-4236, MCA)
- Notice of the sale of the bonds must be published as required by Sections 7-7-4251 and 4252, MCA.

**Suggested Audit Procedure:**

- Obtain a copy of the required resolution and determine that it meets the requirements listed in Section 7-7-7236, MCA, and that notification of the sale of the general obligation bonds was published as required.

**3.     Compliance Requirements:**

- The city or town council may fix the minimum price for the bonds in an amount not less than 97% of the face value if the city or town council determines that the sale is in the best interests of the city or town. (Section 7-7-4236(4), MCA)
- General obligation bonds may not be sold by a city at less than the minimum bid specified for their sale with accrued interest to the date of delivery. (Section 7-7-4254, MCA)
- The council shall accept the bid that it judges most advantageous to the city or town. (Section 7-7-4254, MCA)

<b>PROGRAM/SUBJECT:     Cities and Towns -                                  Long-Term Debt</b>	REF: C/T-8
	PAGE: 4 of 25

**I.       COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:**

**GENERAL OBLIGATION BONDS - continued:**

**3.    Compliance Requirements - continued:**

- The council may reject any bids and sell the bonds at private sale if the council considers it in the best interests of the city or town. (Section 7-7-4254, MCA)

**Suggested Audit Procedure:**

- If general obligation bonds were issued during the audit period, review documentation on file related to the bond sale and determine that the bonds were not sold:
  - a. for less than 97% of the face value of the bonds if the city or town council determines that the sale is in the best interests of the city or town. and.
  - b. at less than the minimum bid specified for their sale with accrued interest to the date of delivery.

**4.    Compliance Requirements:**

- The city treasurer or town clerk must maintain a bond register containing the following information:
    - a. Date of issue;
    - b. The maturities of the bonds subject to early redemption and the redemption dates;
    - c. The dates when the principal and interest on the bonds will become due;
    - d. The amount of all payments of both principal and interest required on each bond with the dates when the payments must be made.
 (Section 7-7-4257, MCA)
  - The city treasurer or town clerk is also to be furnished an unsigned, canceled sample copy of a bond from each issue, which is to be preserved on file. (Section 7-7-4258, MCA)
- (Note: May not apply to registered bonds issued after July 1, 1983.)**

**Suggested Audit Procedure:**

- Review the bond register to determine if it contains the information required by statute, as listed above, and determine if a sample copy of a bond from each issue is on file.

**5.    Compliance Requirement:**

- All bonds and interest coupons that are paid must be canceled, and the amounts of principal and interest paid and the date they were paid must be recorded in a bond register. (Section 7-7-4272, MCA)
- (Note: May not apply to registered bonds issued after July 1, 1983.)**

<b>PROGRAM/SUBJECT:     Cities and Towns - Long-Term Debt</b>	REF: C/T-8
	PAGE: 5 of 25

# **I. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:**

## **GENERAL OBLIGATION BONDS - continued:**

### **Suggested Audit Procedure:**

- Review selected bonds and coupons that have been paid by the city or town and determine if they have been marked paid and that the payment was entered in the bond register.

### **6. Compliance Requirements:**

- There must be a separate sinking fund account for each issue or series of outstanding general obligation bonds. (Section 7-7-4261, MCA)
- All taxes collected for interest and principal on the general obligation bonds must be credited to the sinking fund for which the taxes were levied. (Section 7-7-4261, MCA)
- All investment income from investing moneys of the sinking funds must be credited to the sinking fund. (Sections 7-7-4261, 7-7-123, and 7-7-124, MCA)
- If the bonds are not yet due but are redeemable under optional provisions, money in the sinking fund is not subject to investment but should instead be applied to payment and redemption of the bonds. (Section 7-7-124, MCA)

**(Note: A.G.O. No. 18, Vol. 44, stipulates that money in a sinking fund is not available for investment if any of the bonds for which the sinking fund was established are not yet due but are then redeemable under optional provisions. (Section 7-7-124, MCA) While investment in government securities is authorized under Section 7-7-123, MCA, it is authorized only to the extent that the sinking fund is not needed for payment of the bonds or interest. Therefore, excess bond proceeds may not be retained in a separate fund and invested without first using the proceeds to calculate the amount of annual tax levy for a sinking fund. Any remainder of the proceeds may then be invested in accordance with Section 7-7-123, MCA.)**

### **Suggested Audit Procedures:**

- Review the financial records and determine that the city or town is maintaining separate sinking funds for each series of bonds.
- As part of overall testing of tax revenue (tax distribution) and interest revenue (interest distribution), determine that bond sinking funds are receiving the proper portion of the taxes collected and the proper amount of interest earned from investments.

<b>PROGRAM/SUBJECT:     Cities and Towns - Long-Term Debt</b>	REF: C/T-8
	PAGE: 6 of 25

**I. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:**

**GENERAL OBLIGATION BONDS - continued:**

**Suggested Audit Procedures - continued:**

- Determine whether the bonds have an optional early redemption provision. If so, verify that money in the sinking fund is applied to payment and early redemption of the bonds, rather than being invested.

**7. Compliance Requirement:**

- When all general obligation bonds of any series or issue and all interest have been fully paid and there is money remaining in the bond sinking fund, the excess should be transferred to the general fund or to the sinking and interest fund of any other series or issue of bonds outstanding designated by the city or town council or commission. (Section 7-7-4274, MCA)

**Suggested Audit Procedure:**

- If bonds have been fully paid during the current year, determine that any excess money in the bond sinking fund was transferred to the general fund of the city or town, or to the sinking and interest fund of another bond issue if so designated by the city or town council or commission.

**8. Compliance Requirement:**

- In order for a city or town to issue general obligation refunding bonds, the council must adopt a resolution setting forth the facts regarding the bonds to be refunded, showing the reason for issuing such refunding bonds, and fixing and determining the details of such refunding bond issuance, including whether the bonds will be sold at a private negotiated sale or a public sale. (Section 7-7-4311, MCA)

**Suggested Audit Procedure:**

- If the city or town issued general obligation refunding bonds during the audit period, determine that the bonds were issued pursuant to a resolution of the council that contains all required information as described above.

**9. Compliance Requirements:**

- Bonds of the city or town shall bear interest at such rates or rates as its governing body shall determine. (Section 17-5-102, MCA)
- Except as noted below, general obligation refunding bonds may not be issued unless the refunding bonds bear interest at a rate of at least ½ of 1% less than the interest rate on the outstanding bonds to be refunded. (Section 7-7-4304(1), MCA)

<b>PROGRAM/SUBJECT:     Cities and Towns -                                  Long-Term Debt</b>	REF: C/T-8
	PAGE: 7 of 25

**I.       COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:**

**GENERAL OBLIGATION BONDS - continued:**

**9.    Compliance Requirements - continued:**

- In determining whether the refunding bonds satisfy the savings requirements when variable rate bonds are being refunded, the following must also be considered:  
       *Bonds outstanding for at least 5 complete fiscal years:*  
           if the bonds proposed to be refunded bear interest at a variable rate, the average annual interest rate on the bonds being refunded must be calculated by reference to the interest rate on the bonds currently in effect and over the immediately preceding 5 complete fiscal years of the issuer;  
   **OR**  
       *Bonds outstanding for less than 5 complete fiscal years:*  
           if the variable rate bonds being refunded have not been outstanding longer than 5 complete fiscal years, then the average annual interest rate on the bonds being refunded must be calculated by reference to the interest rate on the bonds being refunded currently in effect and over the total number of complete fiscal years of the issuer since the date of issuance of the bonds.  
       (Section 7-7-4502, MCA)
- General obligation refunding bonds may bear interest in excess of the rate on the refunded bonds if the issuance of the refunding bonds, including the total costs of refunding the bonds, results in a reduction of total debt service cost to the city or town. (Section 7-7-4304(2), MCA)
- **Effective April 28, 2005:** Variable rate refunding bonds may also be issued if the governing body determines that the issuance of variable rate refunding bonds is reasonably expected to result in less interest payable on the refunding bonds than the interest payable on the refunded bonds. (Section 7-7-4304(2), MCA)
- General obligation refunding bonds may be issued in a principal amount greater than the principal amount of the outstanding bonds if there is a reduction of total debt service cost to the city or town. (Section 7-7-4304(3), MCA)

**Suggested Audit Procedures:**

- Review the interest rates on bond issues and determine that they are as set by the governing body.
- Obtain the interest rate of the refunding general obligation bonds and the refunded bonds and determine that the interest rate on the refunding bonds is at least ½ of 1% less than the refunded bonds. If not, determine that the issuance of the refunding bonds, including the total cost of refunding the bonds, results in a reduction of the total debt service costs to the city or town.

<b>PROGRAM/SUBJECT:     Cities and Towns - Long-Term Debt</b>	REF: C/T-8
	PAGE: 8 of 25

**I. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:**

**GENERAL OBLIGATION BONDS - continued:**

**Suggested Audit Procedures - continued:**

- Obtain the principal amount of the refunding general obligation bonds and the refunded bonds and determine that the principal on the refunding bonds is less than the refunded bonds. If not, determine that the issuance of the refunding bonds results in a reduction of the total debt service cost to the city or town.

**10. Compliance Requirements:**

- General obligation refunding bonds may be sold to refund outstanding bonds in advance of when such bonds mature or are subject to redemption.
- The proceeds from the refunding must be deposited in escrow with a suitable banking institution.
- The funds must be invested in “securities that are general obligations of the United States or the principal and interest of which are guaranteed by the United States and which mature or are callable at the option of the holder on those dates and bear interest at those rates and are payable on the dates that are required to provide funds sufficient, with any cash retained in the escrow account, to pay when due the interest to accrue on each bond being refunded to its maturity or redemption date, if called for redemption, to pay the principal of the bond at maturity or upon the redemption date, and to pay any redemption premium.”

**(Note: If the funds initially deposited in escrow are sufficient, without regard to any investment income on those funds, to redeem in full the bonds being refunded as of their redemption date and to pay the principal and interest and premium on the bonds being refunded at their stated maturities, the funds may be invested in the securities described above or in a money market fund that is composed exclusively of eligible securities described in Section 7-6-202, MCA, and that otherwise satisfies the requirements of Section 7-6-202(3), MCA.)**

- The escrow account is irrevocably appropriated to the payment of the principal of and interest and redemption premium on the bonds being refunded.  
(Section 7-7-4316, MCA)

**Suggested Audit Procedure:**

- If general obligation refunding bonds have been issued during the audit period to refund outstanding bonds in advance of when such bonds mature or are subject to redemption, determine that the bond proceeds are properly deposited in an escrow account, invested as provided above, and irrevocably appropriated for the payment of principal and interest on the refunded bonds.



<b>PROGRAM/SUBJECT:     Cities and Towns - Long-Term Debt</b>	REF: C/T-8
	PAGE: 9 of 25

**I. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:**

**GENERAL OBLIGATION BONDS - continued:**

**11. Compliance Requirement:**

- Cities or towns may issue bonds for the purpose of deriving revenue for the payment of a judgment or settlement liability. Property taxes may be levied to amortize the bonds. (Section 2-9-316, MCA)

**Suggested Audit Procedure:**

- If the city or town issued bonds during the audit period to fund a judgment or settlement liability, determine that there was documentation related to the judgment or settlement liability to support the issuance of the bonds.

**12. Compliance Requirement:**

- Bond issues may not be issued in excess of the following terms:
  - a. General obligation bonds - 20 years (the term of a bond issue begins on July 1 of the fiscal year in which the city or town first levies taxes to pay principal and interest on the bonds.) (Section 7-7-4205, MCA)
  - b. Refunding general obligation bonds - 10 years, unless the unexpired term of the bonds to be refunded is more than 10 years, in which case the refunding bonds may be issued for such unexpired term. (Section 7-7-4303, MCA)

**Suggested Audit Procedure:**

- Determine that the terms of any city or town bonds issued do not exceed the limitations described above.

**13. Compliance Requirements:**

- **Prior to April 20, 2005:** - All bonds issued for a longer term than 5 years shall be redeemable at the option of the city or town on any interest payment date after one-half of the term for which they were issued has expired, and it shall be so recited in the bonds.  
(Section 7-7-4206, MCA)
- **Effective April 20, 2005:** - Other than refunding bonds, all bonds issued for a longer term than 5 years must be redeemable at the option of the city or town on any interest payment date after one-half of the term for which they were issued has expired, and the redemption option must be recited in the bonds. (Section 7-7-4206, MCA)

<b>PROGRAM/SUBJECT:      Cities and Towns - Long-Term Debt</b>	REF: C/T-8
	PAGE: 10 of 25

**I. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:**

**GENERAL OBLIGATION BONDS - continued:**

**13. Compliance Requirements - continued:**

- Whenever there is available money in any sinking and interest fund over and above the amount required for payment of principal and interest becoming due on the next interest payment date and sufficient to pay and redeem one or more of the outstanding bonds of the issue or series to which the sinking and interest fund belongs, which bonds are not yet due but are then redeemable or will become redeemable on or before the next interest payment date, the city treasurer or town clerk shall apply the available money in redemption of as many of the bonds as the available money will pay and redeem to a redemption date on or before the next interest payment date, as fixed by the city treasurer or town clerk. (Section 7-7-4268(1), MCA)
- The city treasurer or town clerk shall notify the holder of the bond or bonds, if ownership of the bonds is registered or is otherwise known to the treasurer, the registered owners at their addresses as they appear in the bond registration books, and any bank or financial institution at which the bonds are payable, by mail sent at least 30 days before the redemption date, that bonds will be redeemed and paid on that date. A defect in or failure to give notice may not affect the validity of the proceedings for the redemption of a bond or principal installment not affected by the defect or failure. If the ownership of the bonds is not registered, the city treasurer or town clerk shall also publish in a newspaper of general circulation printed and published in the city or town and, if there is none, then in a newspaper of general circulation in the city or town printed and published in the county in which the city or town is situated a notice that the bond or bonds have been called for redemption and will be paid in full on the redemption date. The notice must be published once, not less than 30 days prior to the redemption date. If actual notice of the call has been received, the holder of a bond may waive published or mailed notice. (Section 7-7-4268(2), MCA)
- If the bonds are payable at a bank or financial institution, the city treasurer or town clerk shall remit to the bank or financial institution, before the redemption date, an amount sufficient to pay and redeem the bonds. If the bonds are not presented for redemption and payment on the redemption date, interest ceases on that date if the funds have been deposited in the bank or financial institution. (Section 7-7-4268(3), MCA)

**Suggested Audit Procedures:**

- If the city or town issued general obligation bonds during the audit period, review a copy of the bond and determine that it clearly indicates that the bonds are redeemable at the option of the city or town as noted above.

<b>PROGRAM/SUBJECT:     Cities and Towns - Long-Term Debt</b>	REF: C/T-8
	PAGE: 11 of 25

# **I. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:**

## **GENERAL OBLIGATION BONDS - continued:**

### **Suggested Audit Procedures - continued:**

- As part of testing long-term debt, verify that no sinking funds had excess monies that could be used to redeem the general obligation bonds. If any are identified, verify that the city or town applied the available money to the redemption of as many of the bonds as there was available money in the manner prescribed by the above statutes.

### **14. Compliance Requirement:**

- A city or town authorized to sell general obligation bonds under Title 7, Chapter 7, MCA, may issue and sell any portion of the bond in denominations of less than \$5,000, either by competitive public sale or directly to members of the public, at preestablished interest rates. These bonds may be known as "citizen bonds." Citizen bonds may be issued for any purpose for which a city or town may issue general obligation bonds. For additional information regarding "citizen bonds" see Sections 7-7-4211 through 7-7-4213, MCA.

### **Suggested Audit Procedure:**

- If a city or town has issued "citizen bonds" under the provisions of Title 7, Chapter 7, Part 42, MCA, during the audit period, determine that the provisions of Section 7-7-4211 through 7-7-4213, MCA, have been complied with.

## **REVENUE BONDS:**

### **15. Compliance Requirements:**

- Revenue bonds may be issued for the acquisition, purchase, construction, reconstruction, improvement, betterment or extension of water and/or sewer systems, public airports, convention facilities, public recreation facilities, public parking facilities, solid waste management systems, or other revenue producing facilities. (Section 7-7-4402 and 4425, MCA)
- These revenue bonds may be issued by resolution of the governing body without an election. (Sections 7-7-4403 and 7-7-4426, MCA)
- When the governing body of the city or town considers it necessary to issue revenue bonds pledging the general credit of the city or town, the issuance of the bonds must be authorized by submitting the question to the registered electors of the city or town at the next general city or town election; at an election that is conducted by mail ballot as provided in Title 13, Chapter 19, MCA; or at a special election that is held in conjunction with a regular or primary election and that the governing body may call for the purpose. (Section 7-7-4426, MCA)

<b>PROGRAM/SUBJECT:     Cities and Towns - Long-Term Debt</b>	REF: C/T-8
	PAGE: 12 of 25

**I. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:**

**REVENUE BONDS - continued:**

**15. Compliance Requirements - continued:**

- The maturity date of the revenue bonds may not exceed 40 years. (Section 7-7-4432, MCA.)

**Suggested Audit Procedures:**

- If revenue bonds have been issued during the audit period, review a copy of the resolution authorizing the bonds and determine if the bonds were issued for an authorized purpose.
- If the revenue bonds were issued pledging the general credit of the city or town, determine that the issuance of the bonds was approved by the registered electors at an election as provided above.
- Determine that the maturity date of the revenue bonds does not exceed 40 years.

**16. Compliance Requirement:**

- The governing body of a city or town that is issuing revenue bonds must prescribe and collect reasonable rates, fees, or charges for the services, facilities, and commodities of the undertaking and shall revise the rates, fees, or charges from time to time whenever necessary so that the undertaking is and remains self-supporting. The property taxes specifically authorized to be levied for the general purpose served by an undertaking or resort taxes approved, levied, and appropriated to an undertaking in accordance with Sections 7-6-4461 through 7-6-4469, MCA, constitute revenue of the undertaking and may not result in an undertaking being considered not self-supporting. The rates, fees, or charges, along with any appropriated property or resort tax collections, must produce revenue at least sufficient to:
  - a. pay when due all bonds and interest on the bonds, the payment of which the revenue has been pledged, charged, or otherwise encumbered, including reserves for bonds; and
  - b. provide for all expenses of operation and maintenance of the undertaking, including reserves.
 (Section 7-7-4424, MCA)

**Suggest Audit Procedure:**

- Review the balances in the various funds and accounts used for each revenue bond issue to determine if there is sufficient revenue to pay all debt service on bonds, notes or other obligations plus operating and maintenance expenses, and to maintain all required reserves.

<b>PROGRAM/SUBJECT:     Cities and Towns - Long-Term Debt</b>	REF: C/T-8
	PAGE: 13 of 25

**I. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:**

**REVENUE BONDS - continued:**

**17. Compliance Requirement:**

- The revenue bond issues or refunding revenue bond issues must comply with the related bond indenture agreements, permissible covenants, and bond ordinances or resolutions. (Sections 7-7-4428, 7-7-4429, and 7-7-4622, MCA)

**Suggested Audit Procedure:**

- Review copies of the bond indenture agreement, bond covenants, or bond ordinances or resolutions. Determine if the city or town is in compliance with the specific requirements.

**18. Compliance Requirement:**

- The governing body must adopt a resolution authorizing the issuance of refunding revenue bonds. (Section 7-7-4621, MCA)

**Suggested Audit Procedure:**

- If refunding revenue bonds were issued during the audit period, determine that the issuance of the bonds was authorized by resolution of the governing body.

**19. Compliance Requirements:**

- When refunding revenue bonds are sold six months or more before the earliest date on which all the bonds being refunded mature or are prepayable, the proceeds from the refunding bonds must be placed in an escrow account with a bank or trust company.
- The bank or trust company may be located within or without the state; it must be a member of the Federal Reserve System; and it must have a combined capital and surplus of not less than \$1 million.
- The proceeds deposited in escrow shall be invested in securities maturing on such dates and bearing interest at such rates as shall be required to provide funds sufficient to pay, when due, the interest due on each bond refunded to its maturity or, if it is prepayable, to the earliest date upon which the bond may be called for redemption; and to pay and redeem the principal amount of each such bond at maturity or, if prepayable, at its earliest redemption date; and to pay any premium required for early redemption.

<b>PROGRAM/SUBJECT:     Cities and Towns - Long-Term Debt</b>	REF: C/T-8
	PAGE: 14 of 25

**I. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:**

**REVENUE BONDS - continued:**

**19. Compliance Requirements - continued:**

- The funds must be invested in general obligations of the United States government, securities whose principal and interest payments are guaranteed by the United States government, and securities issued by the following United States government agencies: banks for cooperatives, federal home loan banks, federal intermediate credit banks, federal land banks, and the federal national mortgage association.

(Section 7-7-4504, MCA)

**Suggested Audit Procedure:**

- If refunding revenue bonds were issued during the audit period, determine that the proceeds were placed in an escrow account with a legally authorized bank or trust company, and that they have been properly invested as provided by law.

**20. Compliance Requirement:**

- The maturity date of the refunding revenue bonds may not exceed the useful life of the project or enterprise, as determined by the governing body, and in any event may not exceed 40 years. (Section 7-7-4610, MCA)

**Suggested Audit Procedure:**

- If refunding revenue bonds were issued during the audit period, determine that the maturity date of the refunding bonds does not exceed the useful life of the project or enterprise, or a maximum of 40 years.

**21. Compliance Requirements:**

- Bonds of the city or town shall bear interest at such rates or rates as its governing body shall determine. (Section 17-5-102, MCA)
- Refunding revenue bonds may not be issued unless their average annual interest rate, computed to their stated maturity dates and excluding any premium from such computation, is at least  $\frac{3}{8}$  of 1% less than the average annual interest rate on the bonds that are being refunded, computed to their respective stated maturity dates. Refunding bonds may bear interest at a rate lower or higher than the bonds refunded if:
  1. they are issued to refund matured principal and interest for the payment of which revenues on hand are not sufficient;

<b>PROGRAM/SUBJECT:     Cities and Towns -                                  Long-Term Debt</b>	REF: C/T-8
	PAGE: 15 of 25

**I.       COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:**

**REVENUE BONDS - continued:**

**21.   Compliance Requirements - continued:**

2. the refunding bonds are combined with an issue of new bonds for reconstruction, improvement, betterment, or extension and the lien of the new bonds upon the revenues of the undertaking or project is junior and subordinate to the lien of the outstanding bonds refunded;
  3. the issuance of the refunding bonds, including the total cost of refunding the bonds, results in a reduction of total debt service cost to the city or town, or
  4. **Effective April 28, 2005:** - the governing body determines that the issuance of variable rate refunding bonds is reasonably expected to result in less interest payable on the refunding bonds than the interest payable on the refunded bonds.  
(Section 7-7-4502, MCA)
- In determining whether the refunding bonds satisfy the savings requirements when variable rate bonds are being refunded, the following must also be considered:  
*Bonds outstanding for at least 5 complete fiscal years:*  
if the bonds proposed to be refunded bear interest at a variable rate, the average annual interest rate on the bonds being refunded must be calculated by reference to the interest rate on the bonds currently in effect and over the immediately preceding 5 complete fiscal years of the issuer;  

**OR**

*Bonds outstanding for less than 5 complete fiscal years:*  
if the variable rate bonds being refunded have not been outstanding longer than 5 complete fiscal years, then the average annual interest rate on the bonds being refunded must be calculated by reference to the interest rate on the bonds being refunded currently in effect and over the total number of complete fiscal years of the issuer since the date of issuance of the bonds.  
(Section 7-7-4502, MCA)

**Suggested Audit Procedures:**

- Review the interest rates on bond issues and determine that they are as set by the governing body.
- Obtain the interest rate of the refunding revenue bonds and the refunded bonds and determine that the interest rate on the refunding bonds is at least  $\frac{3}{8}$  of 1% less than the average annual interest rate on the bonds that are being refunded. If not, determine that one of the exceptions listed above applies.

<b>PROGRAM/SUBJECT:     Cities and Towns - Long-Term Debt</b>	REF: C/T-8
	PAGE: 16 of 25

# **I. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:**

## **REVENUE BONDS - continued:**

### **22. Compliance Requirements – Effective July 1, 2006 – Revenue bonds for Urban Highway System Projects:**

- Upon approval by the Montana Transportation Commission, a city or consolidated city-county government may issue revenue bonds to finance the construction and construction engineering phases of projects on the urban highway system within its jurisdiction to:
    - (a) fund the share that the bond issuer might otherwise expend for proportionate matching of federal funds allocated for the construction of highways, roads, streets, or bridges;
    - (b) make a deposit to a reserve fund securing the bonds; and
    - (c) pay costs of issuance and sale of the bonds.
 (Section 7-7-110(1), MCA)
  
  - The bonds may be authorized by a resolution adopted by the governing body without need for authorization by the electors. The resolution must establish the terms, covenants, and conditions of the bonds. The resolution may authorize that the bonds be issued under and secured by a trust indenture between the issuer and a trustee, which may be a trust company or bank having the power of a trustee inside or outside the state. The bonds may be sold at public or private sale, on terms and at prices that the governing body determines to be advantageous. (Section 7-7-110(2), MCA)
- (Note: The bonds do not constitute and may not be included as an indebtedness or liability of the issuer for purposes of any statutory debt limitation, do not constitute general obligations, and may not be secured by the taxing power of the issuer.)**
- The bonds are payable from and secured by the grants or other funds payable to and received by the Montana Department of Transportation (MDOT) and apportioned by the MDOT to the issuer of the bonds for urban highway system improvements or for improvements conducted as provided in 15-70-101(2) (i.e., gas tax apportionment) . In the resolution or the trust indenture providing for the issuance of the bonds, the governing body shall irrevocably pledge and appropriate to the debt service fund from which the bonds are payable the funds apportioned or to be apportioned to the issuer by the MDOT in an amount sufficient to pay the principal of and the interest on the bonds as due. (Section 7-7-110(3), MCA)



<b>PROGRAM/SUBJECT:      Cities and Towns - Long-Term Debt</b>	REF: C/T-8
	PAGE: 17 of 25

**I. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:**

**REVENUE BONDS - continued:**

**22. Compliance Requirements – Effective July 1, 2006 – Revenue bonds for Urban Highway System Projects - continued:**

- Bonds may be issued only if:
  - (a) the bonds are issued in principal amounts and on terms that provide that the amount of principal and interest due in any fiscal year on the bonds and on any other revenue bonds of the issuer outstanding and issued for urban highway systems does not exceed the amount of the revenue pledged to the payment of the bonds and to be received in that fiscal year as estimated by the governing body in the resolution authorizing the issuance of the bonds; and
  - (b) the final maturity of the bonds is not more than 20 years after the date of issuance of the bonds.
 (Section 7-7-110(4), MCA)
- Proceeds from the sale of the bonds must be used to fund urban highway system projects approved by the Transportation Commission through an agreement with the issuer in accordance with Section 60-2-127(4), MCA, and the proceeds to be used for the construction must be deposited with the MDOT. The proceeds must be expended by the MDOT in accordance with other applicable provisions of law. (Section 7-7-110(5), MCA)
- A city or consolidated city-county government issuing bonds for urban highway systems shall certify to the director of MDOT and the director of the Department of Administration promptly upon the issuance of the bonds the principal amount and terms of the bonds and the amount of money required each fiscal year for the payment of principal and interest on the bonds. (Section 7-7-110(6), MCA)

**Suggested Audit Procedures:**

- If urban highway system revenue bonds have been issued during the audit period, review a copy of the resolution authorizing the bonds and other documentation to verify that the local government complied with the above requirements.
- Verify that the maturity date of the urban highway system revenue bonds does not exceed 20 years.

<b>PROGRAM/SUBJECT:     Cities and Towns - Long-Term Debt</b>	REF: C/T-8
	PAGE: 18 of 25

**I. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:**

**TAX, REVENUE, OR BOND ANTICIPATION NOTES:**

**23. Compliance Requirements:**

- Cities or towns may sell short-term obligations in anticipation of taxes or revenues to be received during the fiscal year in which the obligations are issued. The proceeds must be solely expended for the purposes for which the taxes or revenues were appropriated and for costs related to the sale of the notes. (Section 7-6-1102, MCA)
- The principal and interest on the notes must be repaid from the taxes and revenues in anticipation of which they were issued, income from investment of the proceeds of the obligations, and any money otherwise legally available for this purpose. (Section 7-6-1102, MCA)
- The issuance of tax or revenue anticipation notes (short-term obligations) must be authorized by an ordinance or resolution that fixes the maximum amount of the obligations to be issued or, if applicable, the maximum amount that may be outstanding at any time; the maximum term and interest rate or rates to be borne by the obligations; the manner of sale; the maximum price; the form of the obligations, including bearer or registered; the terms; the conditions; and the covenants of the obligations. (Section 7-6-1103, MCA)

**Suggested Audit Procedures:**

- If tax or revenue anticipation notes (short-term obligations) were issued during the audit period, review a copy of the ordinance or resolution authorizing their issuance and determine that it includes the items listed above.
- Test expenditures to determine that the proceeds were used for the purposes for which the taxes or revenues were appropriated, and for costs and expenses related to the issuance and sale of the notes.
- Determine that the payments of principal and interest on the notes were made from the receipt of the anticipated taxes and revenues, or from other allowable sources noted above.

**24. Compliance Requirement:**

- Tax or revenue anticipation notes (short-term obligations) may be renewed or refunded, but may not be renewed or refunded to a date later than 6 months from the end of the fiscal year in which the original short-term obligation was issued. (Section 7-6-1105, MCA)

<b>PROGRAM/SUBJECT:     Cities and Towns - Long-Term Debt</b>	REF: C/T-8
	PAGE: 19 of 25

**I. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:**

**TAX, REVENUE, OR BOND ANTICIPATION NOTES - continued:**

**Suggested Audit Procedure:**

- If tax or revenue anticipation notes (short-term obligations) have been renewed or refunded, determine that the new payable date was not later than 6 months from the end of the fiscal year in which the original short-term obligation was issued.

**25. Compliance Requirements:**

- The city or town council may by resolution issue and sell notes in anticipation of the receipt of a state or federal grant or loan, or the sale of bonds. The amount of the notes may not exceed the total amount of bonds authorized and maturing within not more than 3 years from the date on which the notes are issued. Before the notes are issued, the city or town must receive a written commitment for a grant, loan, or bond purchase in an amount that is not less than the principal amount of the notes. (Section 7-7-109(2), MCA)
- The proceeds of the grant, loan, or bonds must be credited to the debt service fund for the notes as may be needed for their payment, with interest, when due. (Section 7-7-109(3), MCA)

**Suggested Audit Procedures:**

- If revenue or bond anticipation notes were issued during the audit period, determine that the city or town had received a written commitment for a grant, loan, or bond purchase in an amount at least equal to the principal amount of the notes. Determine that the amount of the notes did not exceed the amount of bonds authorized and maturing within not more than 3 years of the issuance date of the notes.
- Determine that the proceeds of the grant, loan, or bonds were credited to the debt service fund for the notes, as may be needed for their payment, with interest, when due.

**DEBT LIMITATIONS:**

**26. Compliance Requirements:**

- Except as provided in 7-7-4402 (next compliance requirement), a city or town may not issue bonds or incur other indebtedness for any purpose in an amount that with all outstanding and unpaid indebtedness exceeds 1.51% of the total assessed value of taxable property, determined as provided in Section 15-8-111, MCA, within the city or town, as ascertained by the last assessment for state and county taxes. (Section 7-7-4201, MCA)

<b>PROGRAM/SUBJECT:     Cities and Towns - Long-Term Debt</b>	REF: C/T-8
	PAGE: 20 of 25

**I. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:**

**DEBT LIMITATIONS - continued:**

**26. Compliance Requirements - continued:**

**(Note: These debt limitations apply to the authorization and issuance of bonds occurring on or after July 1, 2001, and do not apply to bonds authorized before July 1, 2001, regardless of when the bonds were issued)**

- A city or town may incur an additional indebtedness by borrowing money or issuing bonds beyond the amount authorized in 7-7-4201 above for the purpose of constructing a sewer system, procuring a water supply, or constructing or acquiring a water system for a city or town that owns and controls the water supply and water system and devotes the revenue from the water supply and water system to the payment of the debt. (Section 7-7-4202(1), MCA)  
**(Note: This additional total indebtedness that may be incurred by borrowing money or issuing bonds for the construction of a sewer system, for the procurement of a water supply, or for both of the purposes, including all indebtedness that is contracted and that is unpaid or outstanding, may not in the aggregate exceed 55% over and above the debt limitation referred to above in 7-7-4201. (Section 7-7-4202(2), MCA))**
- The following are the exceptions to the amount of indebtedness and are not included as debt for purposes of the above debt limitations:
  - a. the issuing of bonds for the purpose of funding or refunding outstanding warrants or bonds is not the incurring of a new or additional indebtedness but is merely the changing of the evidence of outstanding indebtedness. (Section 7-7-4201(2), MCA)
  - b. bonds issued for the repayment of tax protests lost by the city or town. (Section 7-7-4201(3), MCA)
  - c. bonds refunded pursuant to Section 7-7-4316, MCA, (i.e., the defeased bonds that have been placed in an irrevocable trust) are not to be considered outstanding for purposes of Section 7-7-4201, MCA, or any other debt limitation. (Section 7-7-4316(4), MCA)
  - d. tax or revenue anticipation notes (short-term obligations) issued pursuant to Title 7, Chapter 6, Part 11, MCA. (Section 7-6-1115, MCA)
  - e. revenue bonds issued under the provisions of Title 7, Chapter 7, Part 44, MCA, do not constitute a debt of the municipality within the meaning of any constitutional or statutory limitation or provision. (Section 7-7-4423, MCA)
  - f. bonds issued for funding a self-insurance or deductible reserve fund do not constitute debt within the meaning of any statutory debt limitation. (Section 2-9-211(5))

<b>PROGRAM/SUBJECT:     Cities and Towns - Long-Term Debt</b>	REF: C/T-8
	PAGE: 21 of 25

# **I. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:**

## **DEBT LIMITATIONS – continued:**

### **Suggested Audit Procedure:**

- Determine the total amount of bonds outstanding and other indebtedness of the city or town, excluding those types of debt noted above that are not to be considered as debt for the purpose of the statutory debt limitations. Determine the total assessed value of taxable property, determined as provided in Section 15-8-111, MCA, within the city or town, as ascertained by the last assessment for state and county taxes. Compare the assessed value to the total bonds outstanding and other indebtedness of the city or town and determine that the city's or town's indebtedness is within the debt limitations described above.

**(Note: Usually the determination of whether or not a city or town is in compliance with the debt limitations should be made prior to the time the new indebtedness is incurred. Normally audit tests for the debt limits are conducted in any year that new debt is issued.)**

## **BONDS ISSUED FOR SELF-INSURANCE OR DEDUCTIBLE RESERVE FUND:**

### **27. Compliance Requirement:**

- A city or town may sell bonds or notes for the purposes of funding a self-insurance or deductible reserve fund and the associated costs. The amount may not exceed 0.18% of the total assessed value of taxable property, determined as provided in Section 15-8-111, MCA, within the city or town as of the date of issuance. The bonds or notes must be authorized by resolution of the governing body and are payable from an annual property tax levy authorized by Section 2-9-212, MCA. Bonds or notes issued for this purpose do not constitute debt within the meaning of any statutory debt limitations. (Section 2-9-211(5), MCA)

### **Suggested Audit Procedures:**

- If bonds or notes are sold during the audit period for purposes of funding a self-insurance or deductible reserve fund, determine that they were authorized by resolution of the governing body, and that the amount of the bonds or notes issued did not exceed the limits as described above.
- Determine that proceeds from the property tax levy authorized by Section 2-9-212, MCA, were used for the payment of principal and interest of bonds or notes.

<b>PROGRAM/SUBJECT:     Cities and Towns - Long-Term Debt</b>	REF: C/T-8
	PAGE: 22 of 25

**I. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:**

**OTHER GENERAL OBLIGATION INDEBTEDNESS OF A MUNICIPALITY UNDER SECTION 7-7-4104, MCA**

**28. Compliance Requirements:**

- A municipality may enter into or incur an obligation for any purpose authorized by law (any public or governmental purpose – **effective July 1, 2005**), including the purposes set forth in Section 7-7-4101, MCA (purposes for which indebtedness may be incurred by a municipality). An obligation may be in the form of bonded indebtedness, note indebtedness, a lease, a lease-purchase agreement, an installment purchase contract, or other legal form. An obligation constitutes a general obligation of the municipality but is not secured by a pledge of the taxing power of the municipality.
- The obligation provided for above may be authorized by a resolution adopted by the governing body of the municipality. The resolution must establish the terms, covenants, and conditions of the obligation. It is not necessary to submit the question of incurring the obligation to the electors of the municipality. The obligation may be incurred or sold at public or private sale, on terms and at prices that the governing body determines to be advantageous.
- The obligation does not constitute indebtedness of the municipality for the purpose of statutory debt limitations.
- An obligation may be issued only if:
  - (a) the principal amount of the obligation does not exceed 10% of the general fund budget of the municipality in each of the 2 immediately preceding fiscal years;
  - (b) at the time the obligation is to be incurred, the debt services in the current or in any future fiscal year on the obligation and any other outstanding obligation issued pursuant to this section do not exceed 2% of the revenue deposited in the general fund of the municipality in each of the 2 immediately preceding fiscal years; and
  - (c) the term of the obligation does not exceed 20 years.
- The obligation must clearly state that it is not secured by a pledge of the municipality's taxing power but that it is payable solely from revenue in the general fund in any fiscal year that is pledged to the payment of the obligation.
- In order to secure the payment of principal of or interest on an obligation and related charges, the municipality may grant a first lien on all revenue collected and deposited in the general fund subject to or on a parity with any prior pledges. The municipality may establish other funds and accounts for obligations issued under this section that may be necessary to provide for the priority and segregation of revenue deposited in the general fund and pledged to the payment of obligations.

<b>PROGRAM/SUBJECT:     Cities and Towns -                                  Long-Term Debt</b>	REF: C/T-8
	PAGE: 23 of 25

**I.       COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:**

**OTHER GENERAL OBLIGATION INDEBTEDNESS OF A MUNICIPALITY UNDER SECTION 7-7-4104, MCA – continued:**

**28.   Compliance Requirements - continued:**

- All obligations incurred under this section are legal and valid obligations of the municipality issuing the obligations, and the general credit of the municipality is irrevocably pledged for the prompt payment of both the principal of and interest on the obligations as they become due. However, the municipality may not be obligated to levy taxes for the payment of any obligation or interest on the obligation.
- To the extent that the above provisions are inconsistent with provisions of any other general, special, or local law, the provisions of this section are controlling.

(Section 7-7-4104, MCA)

**Suggested Audit Procedure:**

- If the municipality enters into or incurs an obligation under the provisions of Section 7-7-4104, MCA, during the audit period, review documentation on file to determine if the above requirements were met.

**LONG-TERM LEASE FOR DETENTION FACILITY OPERATION:**

**29.   Compliance Requirements:**

- A local governmental entity may enter into a long-term lease or agreement, not to exceed a term of 30 years, with a corporation proposing to operate a regional detention facility under Title 53, Chapter 30, Part 5, MCA.
- The local governmental entity may agree in the long-term lease or agreement to acquire the facility from the corporation through a lease or a lease option to purchase, subject to the limitations of Title 7, Chapter 7, Part 21, MCA. (Section 53-30-511, MCA)

**Suggested Audit Procedures:**

- Determine if the city or town entered into lease or agreement with a corporation proposing to operate a regional detention facility.
- If so, determine that the lease did not exceed a term of 30 years.
- If a lease exists, determine that it is appropriately reported in the financial statements and disclosed in the notes to the financial statements (i.e., capital lease or operating lease)

<b>PROGRAM/SUBJECT:     Cities and Towns -                                  Long-Term Debt</b>	REF: C/T-8
	PAGE: 24 of 25

**I.       COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:**

**INSTALLMENT PURCHASE CONTRACTS:**

**30.   Compliance Requirement:**

- When the amount to be paid under an installment purchase contract exceeds \$4,000, the council may provide for the payment of the amount in installments extending over a period of not more than 10 years if at the time of entering into the contract, there is an unexpended balance of appropriation in the budget for the then-current fiscal year available and sufficient to pay for the portion of the contract price payable during the then-current fiscal year. The budget for each following year in which any portion of the purchase price is to be paid must contain an appropriation for the purpose of paying that portion. The limitations contained in this here do not apply to installment purchase contracts entered as described in Compliance Requirement Number 28 above. (Section 7-5-4306, MCA)

**Suggested Audit Procedures:**

- Review contract documents for installment purchases to determine that the purchase cost was at least \$4,000 and that the installment period does not exceed 10 years.
- Determine that there were sufficient budget appropriations to pay each year's portion of the contract price.

**CLEAN RENEWABLE ENERGY BOND PROGRAM ("CREBs")**

**31.   Compliance Requirement:**

- The Energy Tax Incentives Act of 2005 authorized the issuance nationally of tax credit bonds to finance certain renewable energy projects (Clean Renewable Energy Bonds or "CREBs"). Qualified issuers of these CREBs include a "governmental body". Projects eligible for CREBs are identified in Section 45 of the U.S. Tax Code and include wind facilities, closed and open-loop biomass, solar energy, qualified hydro facilities, small irrigation facilities, geothermal energy, landfill gas, trash combustion and refined coal production. These projects are intended to produce sufficient energy to provide for the local government's needs, allowing excess energy to be sold through the grid. The CREBs that local governments would issue would be payable from the revenues generated by the sale of the excess power and general fund revenue that would otherwise go to the purchase of electrical energy. A qualified issuer can issue CREBs to a qualified borrower between January 1, 2006 and December 31, 2007.



<b>PROGRAM/SUBJECT:</b> <b>Cities and Towns - Long-Term Debt</b>	REF: C/T-8
	PAGE: 25 of 25

**I. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:**

**CLEAN RENEWABLE ENERGY BOND PROGRAM (“CREBs”) – continued:**

**31. Compliance Requirement - continued:**

**NOTE:** It is the opinion of Mae Nan Ellingson, Bond Counsel with the Dorsey Law Firm, that there isn’t sufficient authority under Montana law to enable local governments to participate in the CREB program. She and other individuals are proposing legislation for the 2007 Legislature to provide the necessary authority to local governments to participate in the CREB program. However, the applications for the program were due on April 26, 2006, and some local governments have submitted applications to the program. It is Ms. Ellingson’s opinion that approving and signing the application doesn’t in any way obligate local governments to undertake any project, issue any bonds, or otherwise participate in the CREB program. It is anticipated that applicants will hear back from the IRS in June/July 2006.

**Suggested Audit Procedure:**

- **None** – This compliance requirement is included for informational purposes only.